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Briefing note

July 2015

UK Announces New Office of Financial Sanctions Implementation – Will This Mean Better Guidance, Increased Penalties and More Enforcement?

On 8 July 2015, the UK government published its Summer Budget 2015. Deep in the detail of the supporting policy decisions, at paragraph 2.185, the government announced its plans to establish a new "*Office of Financial Sanctions Implementation*". The new office, which is to be established within HM Treasury during this financial year, will be tasked with ensuring not only that businesses in the private sector are made better aware of the sanctions rules they are being asked to comply with, but also with ensuring that sanctions are "*properly enforced*".

The Budget announcement stated that the proposed new office will "*work closely with law enforcement*" in this endeavour and that the government will also "*legislate early in this Parliament to increase the penalties for non-compliance with financial sanctions*."

The Budget announcement may be welcomed by British business for the prospect of greater assistance in understanding sanctions compliance expectations. Yet it may also portent efforts to emulate US-style enforcement; and that could be cause for concern.

The full statement in the Summer Budget Announcement is as follows:

"The government has reviewed the structures within HM Treasury for the implementation of financial sanctions and its work with the law enforcement community, to ensure these sanctions are properly enforced and businesses are made better aware of the rules they are being asked to comply with. The Chancellor of the Exchequer will establish this financial year an Office of Financial Sanctions Implementation within the Treasury. The Office will provide a high quality service to the private sector, working closely with law enforcement to help ensure that financial sanctions are properly understood, implemented and enforced. This will ensure financial sanctions make the fullest possible contributions to the UK's foreign policy and national security goals and help maintain the integrity of and confidence in the UK financial services sector. The government will also legislate early in this Parliament to increase the penalties for non-compliance with financial sanctions."

In making this announcement, the UK government may well have its eyes set on the large fines that have been imposed in sanctions enforcement cases on the other side of the Atlantic. Indeed, in its pre-election budget in April this year, the government stated that in reviewing its enforcement structures, HM Treasury will "*take into account lessons from structures in other countries, including the US Treasury Office of Foreign Assets Control*".

In recent years the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury has imposed record fines on financial institutions and corporate entities for violations of US sanctions rules and regulations. Other US federal and New York state prosecutors and bank regulators have imposed even larger penalties by reference to the same underlying transactions, based on their own enforcement authority and theories. And yet, while economic sanctions continue to feature in the headlines, the number of enforcement cases in the UK to date has been limited.

Whether that will change with the yet to be created Office of Financial Sanctions Implementation (or "OFSI", as we will refer to it for the purposes of this briefing) remains to be seen. The relative dearth of prosecutions to date is unlikely to be an issue solely of internal resourcing within HM Treasury. Under current UK legislation, financial sanctions can only be enforced by initiating a criminal prosecution, whereas OFAC has the power to issue administrative subpoenas, impose civil penalties, and, crucially, to agree settlements with violators under a published set of "Enforcement Guidelines". While the Financial Conduct Authority (FCA) can impose fines and other penalties on the firms it regulates for failing to have adequate systems and controls in place to comply with financial sanctions, HM Treasury and the prosecuting authorities have no power to settle cases for breaches of financial sanctions legislation, and the threshold for establishing the liability of corporate entities remains high.

Although the deferred prosecution regime does not currently extend to financial sanctions, it is possible that it may eventually be extended to apply to financial sanctions, although this would require legislative change. Alternatively, HM Treasury or another enforcing authority could be given powers to impose compound penalties in the same manner as HM Revenue & Customs enforces export control violations, settling with alleged offenders rather than referring prosecutions to the Crown Prosecution Service. At this stage, however, the only reference in the Budget announcement is to planned increases in the penalties for non-compliance. There is no mention of deferred prosecutions or the use of other enforcement tools.

Indeed, while an increase in penalties may have a deterrent effect, penalties under existing legislation already include imprisonment of up to 2 years and/or an unlimited fine (for breaches of sanctions set out in EU Regulations) or 10 years and/or an unlimited fine (for breaches of other sanctions). Also, where an offence is committed by a body corporate, officers, directors and managers may also be held liable if, for example, the offence was committed with their consent or attributable to their neglect.

The new focus on enforcement, even if it does lead to a greater risk of prosecution, seems unlikely to lead to the kind of large-scale non-transparency cases that have been a feature of US multi-agency enforcement in the past decade. The high profile actions in the US, predominantly against non-US financial institutions, have largely focused on specific fact patterns that, broadly speaking, have involved banks outside the US removing from or intentionally not including information in payment messages sent to the US, where that information might otherwise have identified the involvement of US sanctions targets. US authorities refer to this type of intentional omission of information as non-transparency. In the UK, under current jurisdictional rules, there is unlikely to be any scope for cases of this type based on similar theories. Instead, there is likely to be greater focus on enforcement for breaches within the UK of what is no doubt an increasingly complex set of rules and regulations.

As well as enforcement, one of the stated aims of OFSI is to make companies "better aware" of the sanctions rules they are being asked to comply with and to provide a "high quality service" to the private sector.

A common issue in relation to financial sanctions is the uncertainty that can flow from the sometimes imprecise language used in the legislation. However, in contrast with OFAC (which is in large part the final arbiter of the meaning of its own rules for purposes of its own enforcement of them), when it comes to the interpretation of EU sanctions, the process of gaining EU wide guidance is cumbersome as it requires coordination of the views of Member States. Moreover, interpretational guidance issued by EU authorities and by HM Treasury is not binding and ultimately subject to the views of the courts.

The recent sanctions imposed in 2014 in relation to Russia, in particular the so-called sectoral sanctions set out in EU Council Regulation 833/2014, are a good example of directly applicable sanctions that have caused significant interpretational uncertainty and therefore disruption in the markets. The matter is further complicated by the fact that EU Regulations are published in 24 languages and each published version is considered authentic. Uncertainty is compounded where different EU Member States adopt different approaches to the meaning of specific restrictions. While ultimately the EU Commission has issued guidance as to the meaning of some of the prohibitions, it did not do so until several months after the legislation came into effect, and only in respect of certain rules. In the US, OFAC issued guidance in relation to equivalent US sanctions in a more timely manner and, arguably, more clearly.

If the creation of OFSI results in the allocation of more resources towards addressing uncertainties, issuing licences and publishing guidance, then the OFSI will be a welcome development. But additional resources and capacity may not completely eliminate the logjams that can occur at times when new sanctions laws have been implemented, and the volume of requests leads to significant delays in responding to licence applications and queries. Given that most UK financial sanctions arise by way of EU regulation, it seems likely that HM Treasury will be unable to provide an equivalent level of service to OFAC, at least until such time as an effective coordinating authority may be introduced at EU level.

It may well be, therefore, that with the creation of OFSI, the service provided to the private sector is improved, if not changed fundamentally. What is clear is that as the government looks at the possibilities of increasing enforcement, the risks associated with failing to get it right in relation to sanctions compliance will remain as high as ever.

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